

Property Exposure Climbing

In the 90s, most institutions and pension funds were getting shot of large chunks of their property portfolios. Property – both directly held and listed – was generally rated as the worst asset class to be in back then, as an oversupply of commercial space kept a firm lid on rental and capital growth.

Subsequently, institutional investment in property as a percentage of total assets dropped from an average of 10% in the early 90s to less than 4% a decade later.

But it seems times they are a-changin', to quote Bob Dylan. Many of South Africa's pension funds are now starting to bulk up their exposure to property, as they can no longer ignore the spectacular comeback that commercial bricks and mortar has made over the past two to three years – not only as an income play, but also in terms of capital growth.

The Public Investment Corporation (PIC), SA's biggest pension fund manager with around R700bn of assets under management, has been a particularly staunch supporter of property in recent months. The PIC aims to grow its property portfolio nearly seven-fold over the next five years: from around R11bn (including the recent takeover of the listed fund CBS Property Portfolio) to R70bn. That would see property as a percentage of total assets surge from less than 2% to around 10%.

Other pension fund managers are likely to follow suit. Life assurer Old Mutual has over the past year already lifted its property exposure from around 5% to 7% of pension fund assets under management.

Colin Young, head of institutional investments at Old Mutual Investment Group's (OMIG) property investments, says the current view on portfolio allocation is that property should comprise at least 10% of assets.

Young says recent research conducted in Britain showed that the ideal exposure to property over the past 20 years – ensuring optimum returns on a risk-related basis – would in fact have been as high as 20%.

Although the property holdings of SA's bigger pension funds, such as those of the PIC and Old Mutual, are mostly directly held, the expected increase in money flow to property over the next few years should come mainly via the listed sector.

Anton de Goede, investment analyst at Investec Listed Property Investments, says South African pension funds are expected to follow the global flow of institutional money to listed property as the international move towards transparent and tax-efficient income assets intensifies.

However, the size and liquidity of the South African listed property sector remain a challenge. De Goede says although more money should flow to listed property over the next few years, it's unlikely that South African pension funds will reach the international asset allocation target of 8% to 12% soon.

There's simply not enough property scrip available in South Africa to accommodate a huge increase in demand from pension funds if these target allocations were to be reached. De Goede says despite the market cap of the listed property sector already increasing more than six-fold over the past five years – from around R15bn in 2002 to the current R95bn – property still only represents around 2% of the JSE's total market cap.

So most pension funds are still hesitant to allocate more than 2,5% of their assets to listed property. De Goede says that, examining the share registers of some of the listed property companies, it seems that corporate pension funds haven't yet entered the fray in a meaningful way.

Public pension funds may be a step ahead: not only the PIC but also local government and unionised pension funds. De Goede says many smaller pension funds have achieved listed property exposure via unitised pooled products, although it's difficult to ascertain to what extent from share registers.

He says South Africa's listed property sector needs to double in size to around R200bn to comfortably accommodate the expected increase in demand to reach international standards in asset allocation. The only way that level could be reached is if corporations, Government and institutions bring more of their unlisted property holdings to the market.

De Goede says although a number of big, directly held portfolios have over the past 12 months been acquired by listed funds – including the the Sharemax (R1bn) and Collins (R1bn) portfolios by Old Mutual–managed SA Corporate Real Estate Fund and a R1,4bn Transnet portfolio by Pangbourne Properties – more such deals need to happen.

Meanwhile, existing listed property investors should remain in the pound seats, as increased demand for scrip from pension funds will no doubt continue to support share prices. Latest figures from Catalyst Fund Managers show that listed property has been surprisingly resilient despite recent market volatility. The sector has delivered total returns of 55,5% in the year to end–July.